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No. 91-488

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

KPMG PEAT MARWICK, CONTROL DATA CORPORATION, NORBERT R. BERG, WILLIAM C. NORRIS, ROBERT M. PRICE, and MARVIN G. ROGERS,
Petitioners,

—v.—

DIANE ABBEY, DAVID WEISGAL, WILLIAM STEINER, WILLIAM RANDALL, and JOHN PAGE,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

REPLY BRIEF IN FURTHER SUPPORT OF PETITION

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REPLY BRIEF IN FURTHER SUPPORT OF PETITION

This reply brief responds to the three principal arguments first advanced by respondents in their brief in opposition ("Br. Op.").

I.

This Petition Directly Presents The Fundamental And Unresolved Question Of Whether An Action Under Rule 10b-5 Requires Actual Proof Of Loss Causation, *i.e.*, A Direct Link Between The Asserted Misrepresentation And The Alleged Injury

This Petition presents directly, and on a fully developed and clear trial record, significant legal issues as to the nature of the causation required to establish a claim for damages

under Rule 10b-5, 17 C.F.R. § 240.10b-5 (1991). Respondents assert that the Eighth Circuit "did not issue any ruling of law whatsoever" and seek to characterize the Petition as posing no more than "the routine factual question of whether plaintiffs adduced sufficient evidence at trial to allow their claims to be heard by a jury." Br. Op. 1. In fact, however, the opinion below explicitly turned on the adoption of a specific legal standard of causation, one expressly stated to be at variance with that applied by the district court in dismissing the case at the close of Respondents' proof.

> "We find the district court's view of causation too narrow under legal principles governing Rule 10b(5) cases. Plaintiffs are not required to meet a strict test of direct causation under Rule 10b-5; they need only show 'some causal nexus' between CDC's improper conduct and plaintiff's losses." (933 F.2d at 619; Appendix to the Petition ("App") at 6a)

Respondents' brief in opposition quotes the Eighth Circuit's general "causal nexus" language on several occasions (Br. Op. at 9, 13), but wholly fails to quote or even refer to the explicit rejection of the "direct causation" requirement reflected in the same sentence of the court's opinion. Such "direct causation," the standard adopted by the district court and rejected by the court of appeals, is the "loss causation" referred to by courts in other circuits.[1]

Nor, despite Respondents' efforts, can the Eighth Circuit's opinion otherwise be read to accept the usual understanding of "loss causation." Thus, although the opinion does indeed agree that it is "settled" that "*causation*" is an "essential element of a Rule 10b-5 claim," the court's opinion nowhere distinguishes between loss causation and transaction causa-

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1 *See, e.g., Huddleston* v. *Herman & MacLean*, 640 F.2d 534, 549 n.24 (5th Cir. 1981) (" 'loss causation' refers to a *direct causal link* between the misstatement and the claimant's economic loss"), *aff'd in part and rev'd in part on other grounds*, 459 U.S. 375 (1983) (emphasis added).

tion in the passage referred to by Respondents (Br. Op. at 13) or elsewhere in the opinion. Indeed, although Respondents imply that the court of appeals made such a distinction when it defined causation in terms drawn from this Court's analysis of *reliance* in *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), it is Respondents who add the modifier "transaction" to the word causation in setting out the quotation from the Eighth Circuit's opinion. Br. Op. at 12-13. The opinion itself refers only to "causation," equating such causation with the satisfaction of the *Basic* standard.[2] (933 F.2d at 618, 619-20; App. 4a, 7a) The legal issue, then, could hardly be clearer: is direct proof of causation, *i.e.*, loss causation, a required element of a Rule 10b-5 claim?

Respondents do what they can to suggest that this case requires resolution of a myriad of factual issues and therefore that resolution of the legal issues posed is not appropriate now. But the opinions of each of the courts below recognized the undisputed status of the key evidence. Plaintiffs' own expert conceded that the market price of the Control Data Corporation ("CDC") stock in question was not affected by the announcement of the restatement of earnings. (933 F.2d at 618-19; App. 4a-6a, 16a) This was, as the district court recognized, a concession that no damages were caused by the alleged misrepresentation. (App. 16a) The district court attached controlling significance to this conceded fact, a fact to which the brief in opposition does not even refer. *Id.*

The court of appeals also accepted this undisputed fact. (933 F.2d at 619; App. 5a-6a) It concluded, however, that since a price drop did occur a week later, after reports about CDC's technical violation of certain loan covenants were published, the jury should be allowed to consider whether that later loss could be attributed to the original misstatement of income. It reached this conclusion even though the pub-

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2 As a second line of defense, the brief in opposition dismisses the Eighth Circuit's linkage of "causation" to the standards for reliance as having "no bearing on [the court's] decision to reverse the granting of the directed verdict." Br. Opp. at 13. This is an extraordinarily blithe dismissal of the Eighth Circuit's own contrary language.

lished restatement of income itself produced no change in the stock price and even though the district court held—and the court of appeals agreed—that no evidence of any duty to disclose information about the loan covenants had been presented.[3] (933 F.2d at 620; App. 6a)

The factual record is thus plain and undisputed in the relevant aspects. It allows this Court to determine whether direct proof of loss causation is required or whether, as the court of appeals' analysis suggests, the mere existence of evidence of an alleged misrepresentation and of any subsequent loss without more provides a sufficient legal "nexus" to permit a jury to consider a claim of causation.[4]

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3 Significantly, the district court held that any theory of causation premised on the failure to disclose information pertaining to the loan covenants was barred by Respondents' pre-trial acceptance of the bounds of their case as limited to "misstatements of income." (933 F.2d at 621; App. 10a) The district court excluded expert testimony as to whether any duty existed to disclose information as to the loan covenants and the court of appeals affirmed on this point. (933 F.2d at 621-22; App. 9a-11a) That Respondents from the first approached this as a restatement of income case unrelated to the loan covenants is perhaps most tellingly illustrated by the fact that this suit was brought on August 8, 1985—the day after the first Wall Street Journal article appeared. That article described the restatement of income; unlike the later article, it made no mention of the loan covenants.

4 The Eighth Circuit's own speculation about how the alleged improprieties could have caused injury itself illustrates the problem that arises when there is no requirement that a specific misrepresentation be tied to a particular loss. (933 F.2d at 620; App. 7a) The court of appeals readily acknowledged that the inflation of actual earnings and projected earnings "most obviously" may have been considered "important" in making investment decisions. *Id.* But, as the court recognized, the restatement of such figures, in fact, produced no change in the stock price. (933 F.2d at 620; App. 8a) The court therefore proceeded to speculate on other ways that the alleged misrepresentations may have affected investors' decisions, all in the face of its recognition that "the misrepresented earnings figures did not affect the stock price." *Id.* It is difficult to imagine a clearer instance of an appellate court granting a jury a roving commission to find causation for an injury rebutted by the record itself.

II.

The Second Question Is Properly Presented, Having Been First Framed By The Court Of Appeals In Ruling That the Fraud-On-The-Market Presumption Cannot Be Rebutted With Evidence That The Misrepresentation Alleged "Did Not Affect The Stock Price"

Respondents concede the importance—to this action, to the lower federal courts and to practitioners—of additional guidance from this Court on the vexing question of whether and how the fraud-on-the-market presumption of reliance announced in *Basic Inc.* v. *Levinson*, *supra*, may be rebutted. Br. Op. at 10. But they urge this Court to put off consideration of this question to another day as a matter of discretion, solely on the ground that it has not been sufficiently preserved for review. Br. Op. at 10, 16-17.

Petitioners had no occasion to raise this issue until now. Only the court of appeals' reversal of the district court's grant of a directed verdict as to the element of causation coupled with its simultaneous acknowledgment that "the misrepresented earnings figures did not affect the stock price" (933 F.2d at 620; App. 8a) framed the issue as to which review is sought: can the fraud-on-the-market presumption *ever* be rebutted if even proof that the asserted misrepresentation failed to affect the price of the security in question is insufficient. This Court has recognized that when, as here, the court below passed on the question presented it is fully preserved for review. *See City of Springfield* v. *Kibbe*, 480 U.S. 257, 259, 266 (1987) (per curiam) (O'Connor, J., dissenting), and cases cited therein; R. Stern, E. Gressman & S. Shapiro, *Supreme Court Practice* 364 (6th ed. 1986), and cases cited therein.

III.

The Fully Developed Trial Record In This Case Presents An Ideal Posture For Resolution Of The Questions Presented

Respondents advance the argument that the questions presented by the Petition are not "ripe for review" because "the factual record in this case is not sufficiently developed." Br. Op. at 17. This assertion could not be more wrong: this is the rare case where review by this Court is sought after plaintiffs in a securities fraud action have had the opportunity to present *all* of their evidence *at trial*. That evidence provides a full context in which to assess the correctness of the legal standard applied by the Eighth Circuit. Indeed, the clarity of the record as to the crucial fact establishing the absence of loss causation—the failure of the market to react to the restatement of earnings—provides an unusually "clean" predicate for the Court's legal assessment.

By contrast, many of this Court's notable decisions in the Rule 10b-5 context have been made on far less developed records in pre-trial settings. *See Lampf, Pleva, Lipkind, Prupis & Petrigow* v. *Gilbertson*, 111 S. Ct. 2773 (1991) (summary judgment); *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988) (certification of class action); *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977) (dismissal of complaint for failure to state a claim); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976) (summary judgment); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975) (dismissal of complaint for failure to state a claim).

The procedural posture of this case lends itself to a full exploration of the issues posed. The case is ripe for this Court's review.

CONCLUSION

For the foregoing reasons and the reasons set forth in the Petition, the petition for a writ of *certiorari* should be granted.

Dated: New York, New York
November 4, 1991

Respectfully submitted,

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